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IN THE

Supreme Court of the United States

October Term, 1969

No. 616

RADOM & NEIDORFF, INC.,

Petitioner,

—v.—

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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INDEX

	PAGE
Petition	1
Citation to Opinion Below	1
Jurisdiction	1
Question Presented	2
Statutes Involved	2
Statement	2
Reasons for Granting the Writ	4
Conclusion	7
Appendix A—	
Statutes	9
Regulations	13
Appendix B—	
Opinion	21
Findings of Fact	27

Citations:

Cases:

McCarty v. Cripe, 201 F. 2nd 679 (7th Cir. 1953)	5
McWilliams v. Commissioner, 331 U. S. 694 (1947)	2, 6

Statutes:

Internal Revenue Code 1939:	
Section 23	4
Section 24	2, 5
Section 24(b)	2, 6
Section 24(c)	2, 3, 4
Technical Changes Act of 1953	11

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Petition

Radom & Neidorff, Inc., prays that a writ of certiorari issue to review the judgment of the United States Court of Claims, entered on July 15, 1960, which dismissed the plaintiff's petition.

Citation to Opinion Below

The opinion of the United States Court of Claims, printed together with findings of fact in Appendix B, *infra*, pp. 21-32, is reported at 281 F. 2nd 461.

Jurisdiction

The judgment of the United States Court of Claims was entered on July 15, 1960. Petitioner timely filed a motion

for reconsideration. The order of the United States Court of Claims which overruled the motion was entered on October 5, 1960. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254.

Question Presented

May the Commissioner, for the purpose of disallowing an accrual of otherwise fully deductible expenses, contend for a construction of the language of Section 24 of the Internal Revenue Code which is contrary to that for which he successfully contended in *McWilliams* v. *Commissioner*, 331 U. S. 694 (1947)?

Statutes Involved

The applicable statutory provision is Section 24(c) of the Internal Revenue Code of 1939 (26 U. S. C. Section 24(c), 1952 Edition). Section 24, subsections (b) and (c), and the applicable regulations are printed in Appendix A, *infra*, pp. 9-16.

Statement

This is a tax controversy over the deductibility of salaries of $18,075, which were accrued in 1950 but not paid during that year. The accrual was disallowed by the Commissioner under assertion of the authority of Section 24(c) of the 1939 Code which, in certain enumerated instances, rescinds permission for the deduction of accrued expenses, not paid within 75 days after the termination of the creditor corporation's taxable year. The Commissioner's action resulted in a deficiency of $10,624.17 and an interest charge of $2,683.90, all of which was paid in full. The judgment

of the United States Court of ~~Appeals~~ CLAIMS dismissed the petition for the recovery of these tax payments.

Petitioner is a New York Corporation which had been organized in 1916. Its issued capital stock was owned equally by David Radom and by Henry Neidorff, the husband of David Radom's sister, Anna. Henry Neidorff died on February 18, 1950, and his widow, Anna, inherited his one-half interest in the corporation. Then ensued a personal controversy between David Radom and his sister, Anna Neidorff (R. 29).* Solely by reason of that personal controversy, Anna Neidorff arbitrarily and wrongfully refused to countersign any check for any part of the compensation due to David Radom, so that petitioner was prevented from paying David Radom the compensation to which he was entitled by reason of his services. Therefore, though petitioner had the means to make the payment and sought to make such payment, the accrual of salary could not be liquidated during the taxable year nor within the 75-day period prescribed by Section 24(c). That deduction will be forever lost. Anna Neidorff's refusal to countersign the checks was based on a claim that there was an offset due from David Radom to the petitioner (R. 29, 30).

David Radom was on the cash basis of accounting. He is normally not required to report any part of the unpaid compensation until received, and he did not report the unreceived income in 1950. Petitioner, however, was on the accrual basis of accounting, and deducted the full amount of the compensation as an accrued expense (R. 30).

On July 29, 1954, David Radom mailed a letter to the Director of Internal Revenue in New York in which he stated his consent to the assessment of a deficiency by reason of the applicability of the amendment to Section

* The references marked "R" are to the consecutively paginated certified transcript of the record.

24(c) enacted in the Technical Changes Act of 1953. On August 16, 1954, petitioner also mailed a letter to the same Director to elect to be bound by the provisions of the Technical Changes Act of 1953 (R. 30). The Commissioner took no action on these letters.

The Commissioner's deficiency notice was issued on January 21, 1955. It disallowed the deduction of the entire amount of the accrued salary (R. 30, 31) on the ground that allowance was prohibited by Section 24(c) of the 1939 Code.

Reasons for Granting the Writ

This petition is not simply a prayer for the review of a decision which rejected the interpretation of a statute for which the taxpayer had contended. The overriding question is whether a single section of the Internal Revenue Code of 1939 may be interpreted according to two separate standards depending upon which one results in the basis for the disallowance of a deduction claimed by a taxpayer.

Section 24(c) of the Internal Revenue Code is part of a forfeiture statute. It rescinds statutory authority for the deduction of accrued expenses, in a combination of enumerated circumstances, which would otherwise be fully deductible under Section 23(c). It is unquestioned that the purpose of the legislation is to curb a prevalent technique of tax avoidance which takes advantage of the difference in the years of accountability in the case of creditors on the accrual basis and debtors on the cash basis. The aim of the statute is to limit the year of accountability for the receipt of the payment because otherwise the debtor could freely choose the year most advantageous, tax-wise.

It is clear that the aim of the statute has no relevancy to the facts in this case. Neither the creditor corporation nor

the debtor employee had any choice in this situation, nor were taxes the cause of the problem. The disallowance of the accrual in this case grossly overreaches the Congressional purpose. There is no known Congressional purpose which the disallowance serves. The Commissioner justifies it only on the contention that the statute unfortunately requires it, and the Court of Claims asserts that the language of the statute is too plain and unambiguous to permit construction according to indicated purpose. Thus, though this statute is clearly aimed at a tax avoidance device, it now sweeps into its maw innocent transactions which even the Court of Claims says could not have been among those which Congress could have foreseen. If Congress could not have foreseen it, how can it be said that Congress penalized the transaction?

But the statute is not so plain and unambiguous. Even when judged on its bare language, this statute easily permits a reading which fully accomplishes its purpose without resulting in an absurd conclusion. That reading, which the petitioner had offered, was brushed aside by the Court of Claims without comment. There is no trace in the decision of the reasoning which persuaded the Court of Claims to hold that "... the plain and unambiguous wording of the statute compels the view that as enacted, its scope is much broader."

Nevertheless, that very question, whether the scope of the statute is broader than its purpose, was the question in *McCarty* v. *Cripe*, 201 F. 2d 679 (7th Cir. 1953), and a contrary view was reached. In that case, a loss on a transaction between a husband and wife was held not to be proscribed by Section 24 because the transaction had clearly been an involuntary one. The Seventh Circuit held the statute to the limits of Congressional purpose, a holding which the Court of Claims has declined to follow.

The Seventh Circuit found its authority in the language of the decision in *McWilliams* v. *Commissioner*, 331 U. S. 694, 699 (1947), in which this Court both supplied the definitive interpretation of the statute and also the precedent for interpretation according to legislative purpose. As to the second, this Court said,

> "We conclude that the purpose of §24(b) was to put an end to the right of taxpayers to choose, by intrafamily transfers and other designated devices, their own time for realizing tax losses on investments which for most practical purposes, are continued uninterrupted."

As to the first, this Court said,

> "We are clear as to this purpose, too, that its effectuation obviously had to be made independent of the manner in which an intra-group transfer was completed. Congress with such purpose in mind, could not have intended to include within the scope of §24(b) only simple transfers made directly or through a dummy, or to exclude transfers of securities effected through the medium of the Stock Exchange, unless it wanted to leave a loop-hole almost as large as the one it set out to close."

McWilliams v. *Commissioner, supra,* therefore, reached out for legislative history to supply the interpretation which would enforce Section 24(b) according to Congressional purpose. There was no hesitancy to expand the meaning of a statutory phrase beyond its commonly accepted meaning because the Congressional purpose was clear. Another half of the same legislation is again involved, and the Congressional purpose is just as crystal clear. The only difference is that in *McWilliams,* the end was the disallowance

of a deduction, whereas in this controversy, it will limit the effect of the penalizing section to permit a deduction.

The overriding question of this case, it is submitted, therefore is whether if to effectuate the closing of a tax loop-hole, it is permissible to interpret a statute as broadly as it is necessary to achieve the Congressional purpose, is it an answer to a taxpayer's request for the interpretation of the very same statute in the very same manner, in order to avoid a grave injury which Congress could never have intended, that relief can come only from Congress? Does not the concept of justice require that a statute, once given effect according to statutory intent, must thereafter be given that very same interpretation regardless of whether it is the government or the taxpayer who stands to benefit?

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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December, 1960

APPENDIX A

INTERNAL REVENUE CODE OF 1939

Section 24—Items Not Deductible

(b) LOSSES FROM SALES OR EXCHANGES OF PROPERTY.—

(1) Losses Disallowed.—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in Paragraph (2) (D);

(B) Except in the case of distributions in liquidation, between two corporations more than 50 per than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(C) Except in the case of distributions in liquidation, between two corporations more than 50 per centum in value of the outstanding stock of each of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(D) Between a grantor and a fiduciary of any trust;

(E) Between the fiduciary of a trust and the fiduciary of another trust, if the same person is a grantor with respect to each trust; or

(F) Between a fiduciary of a trust and a beneficiary of such trust.

(2) Stock Ownership, Family, and Partnership Rule.—For the purposes of determining, in applying paragraph (1), the ownership of stock—

(A) Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust, shall be considered as being owned proportionately by or for its shareholders, partners, or beneficiaries;

(B) An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family;

(C) An individual owning (otherwise than by the application of subparagraph (B)) any stock in a corporation shall be considered as owning the stock owned, directly or indirectly, by or for his partner;

(D) The family of an individual shall include only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants; and

(E) Constructive Ownership as Actual Ownership.—Stock constructively owned by a person by reason of the application of subparagraph (A) shall, for the purpose of applying subparagraph (A), (B), or (C), be treated as actually owned by such person, but stock constructively owned by an individual by reason of the application of subparagraph (B) or (C) shall not be treated as owned by him for the purpose of again applying either of such subparagraphs in order to make another the constructive owner of such stock.

(c) Unpaid Expenses and Interest.—In computing net income no deduction shall be allowed under section 23(a), relating to expenses incurred, or under section 23(b), relating to interest accrued—

(1) If such expenses or interest are not paid within the taxable year or within two and one-half months after the close thereof;* and

(2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and

(3) If, at the close of the taxable year of the taxpayer or at any time within two and one half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24(b).

PUBLIC LAW 287 section 202(b)

At the election of a taxpayer (hereinafter in this paragraph referred to as the "payor") made within one year after the date of the enactment of this Act [August 15, 1953], the amendment made by subsection (a) shall also apply with respect to such taxable years of the payor beginning after December 31, 1945, and before January 1, 1951, as are specified by the payor in making such election. Such election for any taxable year shall not be valid as to any amount unless, at or before the time when such election is filed—

(A) the person (hereinafter in this paragraph referred to as the "payee") to whom such amount was payable in-

* Subparagraph (1) was amended by P. L. 287, sect. 202(a) (Technical Changes Act of 1953, c. 512, 67 Stat. 615) to read as follows:

If within the period consisting of the taxable year of the taxpayer and two and one-half months after the close thereof, (A) such expenses or interest are not paid, and (B) the amount thereof is not includible in the gross income of the person to whom the payment is to be made.

cluded such amount in gross income for his taxable year for which such amount was includible in gross income, or

(B) the payee files a written consent to the assessment and collection of any deficiency and interest resulting from the payee's failure to include such amount in gross income for such taxable year, or

(C) the payor pays an amount equal to the deficiency and interest which would be payable by the payee pursuant to subparagraph (B) if he filed such consent. (Any amount paid under this subparagraph shall be assessed, notwithstanding any law or rule of law to the contrary, as an addition to the tax of the payor for the year for which the election is filed.)

The periods of limitation provided in sections 275 and 276 of the Internal Revenue Code on the making of an assessment and the beginning of distraint or a proceeding in court for collection shall, with respect to any deficiency and interest thereon resulting from any consent filed pursuant to subparagraph (B), include one year immediately following the date such consent is filed, and such assessment and collection may be made notwithstanding any provision of law or any rule of law which otherwise would prevent such assessment and collection. If an election by a payor should be filed for a taxable year of the payor for which allowance or credit or refund of an overpayment is barred (at the time of such filing) by any law or rule of law, any consent filed by the payee in respect of any amount which represents expenses incurred or interest accrued by the payor for such year shall be void. If a consent requires the inclusion in the gross income of the payee for any taxable year of an amount which was erroneously included in the gross income of the payee for another taxable year and, on the date the consent is filed, correction of the effect

of the error is prevented by the operation of any provision of the internal-revenue laws other than section 3761 of the Internal Revenue Code (relating to compromises), then the effect of the error shall be corrected in accordance with section 3801 of the Internal Revenue Code as if the consent were a determination under such section 3801 in which there is adopted a position maintained by the Secretary of the Treasury. The Secretary of the Treasury shall prescribe such regulations as may be necessary to carry out the provisions of this paragraph.

TREASURY REGULATIONS 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.24-7 [as amended by T.D. 6089, 1954-2 Cum. Bull. 102] *Disallowance of deductions for Unpaid Expenses and Interest*—(a) In general.—Section 24(c) provides for the disallowance of a deduction for accrued but unpaid expenses and interest under certain circumstances. Subject to the limitations on the application of paragraph (1) (B) to certain taxable years, the deduction is not disallowed unless all the conditions therein exist. The provisions of section 24(c) do not otherwise affect the general rules governing the allowance of deductions under the accrual method. Hence, if the expenses or interest are paid after the deduction has been disallowed, no deduction would be allowable for the taxable year in which payment is made.

(b) *Taxable years beginning before January 1, 1951, where no election made.*—For taxable years beginning before January 1, 1951, where no election is made in accordance with paragraph (d) (2) of this section, the application of section 24(c) may be illustrated by the following example:

Example. A is the holder and owner of an interest-bearing note executed by the M. Corporation all of the stock of which is owned by him. A and the M Corporation make their income tax returns on the basis of a calendar year, but the M Corporation makes its returns on the accrual basis and A makes his returns on the cash receipts and disbursements basis. The M Corporation does not pay any interest on such note during the calendar year 1948 or with 2½ months after the close there, but claims a deduction for the year 1948 with respect to the interest accruing on the note in that year. Since A is on the cash receipts and disbursements basis, the interest is not includible in his gross income for the year 1948. By the application of section 24(c), no deduction for such interest is allowable in computing the net income of the M Corporation for the year 1948.

• • • • •

(d) *Taxable years beginning after December 31, 1945, and before January 1, 1951, where election made.*—(1) General rule.—For taxable years beginning after December 31, 1945, and before January 1, 1951, if the taxpayer makes an election as provided in subparagraph (2) of this paragraph, the provisions of section 24(c), as amended by section 202 of the Technical Changes Act of 1953, and the principles set forth in the example in paragraph (c) of this section shall be applicable.

(2) *Rules Relating to Electic* -(i) Section 202 (b)(2) of the Technical Changes Act of 1953 provides three alternative prerequisites to the making of an election to be subject to section 24(c) as amended—either, under subparagraph (A), the payee included the amount in his gross income for the year in which

it was includible, or, under subparagraph (B), the payee consents to the assessment and collection of any deficiency and interest due to the payee's failure to include the amount in gross income for such taxable years; or, under subparagraph (C), the taxpayer pays the amount which would be payable under subparagraph (B) had the payee filed a consent. The condition relied upon, that is, the inclusion in income by the payee, consent to assessment and collection by the payee, or payment by the payor, must be satisfied at or before the time when the election is filed.

(ii) The election shall be in the form of a statement in writing and shall state the name and address of the taxpayer making the election, and that the taxpayer elects to have the provisions of section 24(c), as amended by section 202 of the Technical Changes Act of 1953, apply to specified taxable years beginning after December 31, 1945, and before January 1, 1951. A separate election shall be filed for each year. The election shall also include the name of the payee, the taxable year in which the amount was included in gross income by the payee (if included), and the district in which the return of the payee for that taxable year was filed. If the taxpayer is relying upon a consent by the payee pursuant to subparagraph (B) of said section 202(b)(2), the taxpayer shall attach a copy of the consent upon which there is noted the time and place of filing of the original. If the taxpayer pays or has paid an amount pursuant to subparagraph (C) of said section 202 (b)(2) he shall state the amount of the payment and the date thereof. The election shall be signed by the taxpayer, if an individual, or, if the taxpayer is not an individual, the election shall be signed in the same manner as the income tax return of the taxpayer.

(iii) The written election must be filed on or before August 15, 1954, in the office of the district director of internal revenue for the district in which the return was filed for the taxable year to which the election relates. An election shall be considered as timely filed if it is placed in the mail on or before midnight of August 15, 1954, as shown by the postmark on the envelope containing the election or as shown by other available evidence of the mailing date.

(iv) A consent by a payee shall be filed in the office of the district director of internal revenue for the district in which his return was filed for the year to which the consent relates. A separate writing, signed by the payee, shall be filed for each year for which a consent is made.

(v) Payment by the taxpayer of an amount pursuant to subparagraph (C) of said section 202(b)(2) shall be made to the district director of internal revenue for the district in which the taxpayer filed his return for the year to which the election relates.

(vi) A copy of the election must be filed with a claim for refund filed on or after the date on which the election is made. Section 202 of the Technical Changes Act of 1953 does not authorize a refund with respect to any taxable year which is barred by any law or rule of law.

(vii) An election which conforms in substance to the provisions of this section shall not be deemed invalid solely because it was filed prior to the date on which the amendment to the regulations in this section was promulgated."

H. REP. No. 1546, 75th Cong., 1st Sess., p. 31 (1939-1 Cum. Bull. (Part 2) 704, 724-725):

SEC. 301 of the Bill—Unpaid Expenses and Interest.

Section 301 also adds to section 24 of the 1936 Act a subsection (c) which denies deductions for unpaid expenses and interest in certain cases. Under existing law, some individuals have attempted to take advantage of the difference in operation between different accounting methods of reporting income to obtain artificial deductions for interest and business expenses. For example, it was found that an individual on the accrual basis became indebted either to an individual with whom he enjoyed a special relationship, such as a member of his family, or to a corporation which he controlled, and his creditor reported income on the cash basis. Thereafter as interest became due on the indebtedness, the debtor on the accrual basis reported the interest as a deduction for income-tax purposes, but he did not make any actual payment to his creditor. Since the creditor was on a cash basis, he reported no income and thus the sum involved escaped income tax altogether, for usually in these cases if the payment were finally made it was done at a time when the creditor had offsetting losses. The use of this device as a practical matter is restricted to situations where the parties occupy special relationships to each other because an ordinary bona fide creditor would not permit his debtor to engage in such a practice.

Your committee recommends that section 24 of the Revenue Act of 1936 be amended by adding a new subsection under which it is provided that where the creditor, by reason of his method of accounting, is not required to include in his gross income the amount of the expenses or the interest until it is paid, no deduction shall be allowed to the debtor under section 23(a) (for expenses) or section 23(b) (for interest)

for sums not paid by the debtor during his taxable year or within two and one-half months after the close of such taxable year. This provision is limited in its application to cases in which both taxpayer and the person to whom the payment is to be made are, at the close of the year of the taxpayer or at any time within two and one-half months thereafter, persons between whom losses would be allowed under section 24(b).

S. REP. No. 685, 83d Cong., 1st Sess., p. 4 (1953-2 Cum. Bull. 526, 528):

SEC. 202. Deduction of Certain Unpaid Expenses and Interest.

In the case of certain closely related taxpayers, such as a corporation and a shareholder owning more than 50 percent of the corporation's stock, section 24(c) of the Code operates to disallow deductions of certain expenses and interest if the following conditions are met:

(1) The amount is not paid within the taxable year or within 2½ months after the close thereof; and

(2) Under the recipient's method of accounting the amount is not, unless paid, includible in his income in the taxable year in which, or with which, the taxable year of the payor corporation ends.

This provision is intended to insure that transactions between such related taxpayers do not operate to shift items of income or deductions. A situation has been called to the attention of your committee, however, where section 24(c) may work an undue workship. For example, a recipient on the cash basis may have an amount credited to his account and made available to him by the corporate payor within 2½ months after

the close of the payor's taxable year so that the recipient must include it in income as an item constructively received in the taxable year so credited. If, however, the corporate taxpayer fails actually to pay over such amount within the period of 2½ months, the item will not be allowed to the corporation as a deduction. Your committee believes that such a case should not fall within the ban of section 24(c) and the bill so provides by an appropriate amendment of requirement (1) above.

The provision is applicable to taxable years of the payor beginning after December 31, 1950, but under certain conditions, set forth to insure that payments will be properly accounted for taxwise with respect to both parties, the payor may elect to make this amendment applicable to taxable years beginning after December 31, 1945, and before January 1, 1951.

H. Rep. No. 894, 83d Cong., 1st Sess., p. 3 (1953-2 Cum. Bull. 508, 510) is to the same effect.

Report of Joint Committee on Tax Evasion and Avoidance, H. Doc. No. 337, 75th Cong., 1st Sess., pp. 15-16 (1937):

The committee had presented to it certain cases wherein individuals were indebted to each other or corporations were indebted to the principal stockholders. In fact it was pointed out that personal holding companies were being utilized for the purpose of establishing artificial deductions. The sole stockholder (or a member of his family) of a personal holding corporation borrowed all or a major part of its annual net income and paid interest thereon. In such cases the debtor kept his books and tax returns on the accrual basis and claimed as deductions the accrued interest. On the other hand, the

creditor who was entitled to such payments, if he were on the cash receipts basis, would not be required to report for income tax purposes, the amount owing to him until actual receipt of the money. Under such circumstances the discharge of the debt may be postponed for an unreasonable length of time with the result that the Government is delayed in getting its tax and in many cases the payments fall in a year of no income with the result that little or no tax is paid. The committee believes that such practices between individuals of a family or between corporations under common control should be dealt with in such a manner as to encourage reasonably prompt discharge of such obligations.

It is, therefore, recommended that in the case of a transaction between persons, who under section 24 (a) (6) are not permitted a deduction for loss from sale or exchange or property, where the debtor makes his return on the accrual basis and the creditor makes his return on the cash basis, deductions—under section 23 (a), (expenses) and under section 23 (b), (interest)—accrued by the debtor within the taxable year but not paid within 2½ months after the close of the taxable year should be disallowed.

This proposal should serve to stimulate reasonably prompt payment of such accrued expenses in order that the debtor may secure the allowance of the deduction. No hardship should result from the requirement that the amount be paid within 2½ months after the close of the year of accrual since expenses of this nature usually should be paid within that time in the ordinary course of business. While this restriction would be applicable only to individuals and corporations in relationships covered by section 24 (a) (6), this class represents the worst offenders in the use of this loophole.

APPENDIX B

IN THE

UNITED STATES COURT OF CLAIMS

No. 173-58

(Decided July 15, 1960)

RADOM & NEIDORFF, INC.

—v.—

THE UNITED STATES

Mr. Michael Kaminsky for the plaintiff. *Messrs. Worthman & Kaminsky* were on the briefs.

Mr. John F. Palmer, with whom was *Assistant Attorney General Charles K. Rice*, for the defendant. *Mr. James P. Garland*, *Mr. Jerome Fink*, and *Miss June A. Murray* were on the brief.

OPINION

LARAMORE, *Judge*, delivered the opinion of the court:

This is an action to recover Federal income taxes and interest allegedly overpaid by plaintiff for the taxable year ended December 31, 1950.

The question presented is whether the deduction of accrued salary expenses otherwise allowable by section 23(a)(1), Internal Revenue Code of 1939, 26 U.S.C. (1952 Ed.), is barred by section 24(c) of the Internal Revenue Code of 1939.

Plaintiff, a taxpayer, is a New York corporation organized in 1916. Its capital stock issued and outstanding was

owned in equal shares by David Radom and Henry Neidorff, the husband of David Radom's sister. Henry Neidorff died on February 18, 1950, and his wife, Anna, succeeded to the ownership and possession of a full one-half interest in the corporation's stock then outstanding. During the year 1950 and subsequently, the said David Radom and the said Anna Neidorff were engaged in a personal controversy relating to the control of plaintiff corporation. During the controversy, it was impossible to obtain the agreement of the stockholders for the election of directors and appointment of officers. The controversy resulted in protracted litigation in the courts of the State of New York for the purpose of obtaining an enforced dissolution of plaintiff. It was eventually held by the New York court that an order for dissolution should not be granted.

During the year 1950, and during the 75-day period thereafter, and solely by reason of said personal controversy, Anna Neidorff arbitrarily and wrongfully refused to countersign any check for any part of compensation due to David Radom in payment for services performed. However, the said Anna Neidorff affixed her signature to all other checks issued by plaintiff. Plaintiff's bank required the said countersignature in each instance or the check would not be paid. David Radom was employed by plaintiff during the entire year 1950 at the agreed annual compensation of $24,400. Radom fully and satisfactorily discharged his duties and was entitled to receive all of the agreed compensation of $24,400. Plaintiff was financially able to make payment but Radom, in spite of repeated attempts by plaintiff to pay the entire amount, received only $6,325. Plaintiff was, however, against its will, unable to make payment of the balance of $18,075 either in installments during the year or by a single payment at the end of the year or within a 75-day period ending immediately after the termination of petitioner's taxable year, which was De-

cember 31, 1950. Plaintiff has at all times admitted liability for the full amount of Radom's salary. Anna Neidorff did not contend that plaintiff was not liable, but alleged an offset was due plaintiff.

Radom was on the cash basis of accounting and consequently did not report as income in 1950 or 1951 any part of the salary due him from plaintiff for the year 1950.

The taxpayer was on the accrual method of accounting and in 1950 accrued the entire obligation of $18,075 as an expense, and deducted the full amount as officer's salary, from gross income reported on its Federal income and excess profits tax returns for the calendar year 1950.

Under date of July 29, 1954, David Radom mailed a letter to the Director of Internal Revenue in New York consenting to any additional assessment due to the application of section 24(c) as amended by the Technical Changes Act of 1953 to his back salaries. Under date of August 16, 1954, plaintiff mailed a letter to the said Director in which it elected to come under the provisions of the Technical Changes Act of 1953 as applied to accrued salaries for the year 1950, under section 24(c).

On January 21, 1955, the Commissioner of Internal Revenue forwarded to plaintiff a statutory notice of deficiency of $10,624.17 in plaintiff's income taxes for the calendar year 1950. The major cause for the claimed deficiency was the disallowance pursuant to section 24(c) of the Internal Revenue Code of 1939 of the entire amount of the deduction against gross income of $18,075.

On or about June 21, 1955, the full amount of the assessment, together with interest in the amount of $2,683.90 was paid to the District Director of Internal Revenue. Plaintiff on September 15, 1955, filed a claim for refund which was rejected on August 9, 1956. This suit results.

Under section 23(a)(1) of the Internal Revenue Code of 1939, *supra*, a taxpayer may deduct from income all ordi-

nary and necessary business expenses "including a reasonable allowance for salaries or other compensation for personal services actually rendered."

Section 24(c) provides that no deduction shall be allowed under section 23(a), relating to expenses incurred, or under section 23(b), relating to interest accrued—

> (1) If within the period consisting of the taxable year of the taxpayer and two and one-half months after the close thereof (a) such expenses or interest are not paid, and (b) the amount thereof is not includible in the gross income of the person to whom the payment is to be made; and
>
> (2) If, by reason of the method of accounting of the person to whom the payment is to be made, the amount thereof is not, unless paid, includible in the gross income of such person for the taxable year in which or with which the taxable year of the taxpayer ends; and
>
> (3) If, at the close of the taxable year of the taxpayer or at any time within two and one-half months thereafter, both the taxpayer and the person to whom the payment is to be made are persons between whom losses would be disallowed under section 24(b).

By 1953 the established judicial trends were (1) to treat negotiable promissory demand or time notes, worth face value, as constituting payment (*Musselman Hub-Brake Co.* v. *Commissioner*, 139 F. 2d 65); (2) to reject constructive payment as payment (*P. G. Lake Inc.* v. *Commissioner*, 148 F. 2d 898); and (3) to permit the deduction of a business expense if the creditor were deemed to have constructively received the amount due him within the taxpayer's taxable year but not if the constructive receipt occurred any time following the close of such taxable year, even within the 2½ month period. *P. G. Lake Inc.* v. *Commissioner, supra.*

Under the Technical Changes Act of 1953, section 202, 67 Stat. 617, amending section 24 of the Internal Revenue Code of 1939, a further test for the application of the statutory restriction was added; *i.e.*, that the creditor must not have constructively received the amount due him either within the taxable year of the taxpayer or within the 2½ months following the close of such year. In other words, for the taxable years beginning after December 31, 1950, if the creditor had actually or constructively received the amount due him, either within the taxable year of the taxpayer or not later than 2½ months following the close of such year, the taxpayer-debtor will not be denied the deduction even though all other requirements for the application of the statutory restriction have been satisfied.

Under the 1953 amendment, *supra*, the taxpayer was given an opportunity to elect to make the new amendment applicable to any taxable year or years of the taxpayer beginning after December 31, 1945 and before January 1, 1951. This election must have been exercised, in accordance with the regulation, before August 16, 1954.

The 1953 amendment provided "such election for any taxable year shall not be valid as to any amount unless, at or before the time when such election is filed—

> (A) the person (hereinafter in this paragraph referred to as the "payee") to whom such amount was payable included such amount in gross income for his taxable year for which such amount was includible in gross income, or
>
> (B) the payee files a written consent to the assessment and collection of any deficiency and interest resulting from the payee's failure to include such amount in gross income for such taxable year, or
>
> (C) the payor pays an amount equal to the deficiency and interest which would be payable by the payee pur-

suant to subparagraph (B) if he filed such consent. (Any amount paid under this subparagraph shall be assessed, notwithstanding any law or rule of law to the contrary, as an addition to the tax of the payor for the year for which the election is filed.)

Plaintiff complied with the above by the letter from Radom to the Director of Internal Revenue whereby he (Radom) agreed to pay any assessment by reason of section 24(c) as amended and the letter to the Director from plaintiff taxpayer stating that it elected to come under the provisions of the 1953 amendment.

The controversy then boils down to this—did the creditor, Radom, either actually or constructively receive payment of his salary within the statutory period, i.e., not later than 2½ months after the close of his taxable year?

It is clear from the record that the answer to this question is in the negative. Because of the refusal of Anna Neidorff to countersign the check, Radom has never received payment. Under these circumstances plaintiff has not met the burden of proving actual or constructive payment within the period required by statute.

There can be no doubt that the primary motivation of Congress in drafting section 24(c) was to prevent tax avoidance. However, the plain and unambiguous wording of the statute compels the view that as enacted, its scope is much broader. Nor does the legislative history bear out plaintiff's contention that the legislation was not meant to apply to a situation such as presented here. Had Congress intended section 24(c) to apply solely in cases of attempted tax avoidance, which is not present here, either the wording of the statute or the legislative history would make such intention clear. Obviously the statute is not so worded and the legislative history does not conclusively show intent to include only situations involving tax avoidance. In other words,

the amendment as written deals with the result of a failure to pay, and permits deduction if the salary was constructively received within the period, even if not actually paid. MERTENS LAW OF FEDERAL INCOME TAXATION, Vol. 4, §25.11 (1954 Ed.).

Obviously Congress could not and did not foresee the events which have taken place and which, by application of the statute, probably results in harsh treatment to the taxpayer. That certain inequities result from the tax laws is a natural consequence of an intricate tax system. However, as the Supreme Court held in *United States v. Olympic Radio & Television, Inc.*, 349 U.S. 232, 236, "* * * But as we have said before, 'general equitable considerations' do not control the question of what deductions are permissible." To grant plaintiff the relief prayed for would either be to invoke equity or to legislate, which in either instance, is not our province. Therefore, plaintiff's petition must be dismissed.

It is so ordered.

DURFEE, *Judge*; MADDEN, *Judge*; WHITAKER, *Judge*, and JONES, *Chief Judge*, concur.

FINDINGS OF FACT

The court, having considered the evidence, the report of Trial Commissioner S. R. Gamer, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiff is a corporation incorporated and existing under the laws of the State of New York. Its office and principal place of business is located at 438 West 37th Street, in the County, City and State of New York.

2. This action is brought for the recovery of income taxes which plaintiff claims were erroneously and illegally col-

lected with respect to the taxable year ending December 31, 1950.

3. Plaintiff timely filed with the Collector of Internal Revenue for the Third District of New York the prescribed income and excess profits tax returns for the calendar year 1950. These returns showed the computation of net income by means of the accrual method of accounting. Plaintiff made timely payments of the full liability of $36,971.63 which had been disclosed on said returns and had been accordingly assessed.

4. One David Radom was employed by plaintiff during the entire year 1950 at the agreed annual compensation of $24,400, serving as plaintiff's president. David Radom fully and satisfactorily discharged his duties, and was entitled to receive all of the agreed compensation of $24,400. David Radom received only $6,325. Plaintiff was financially able to make payment of the unpaid amount of $18,075. Plaintiff, however, was unable to make said payment, either in installments during the year, or by a single payment at the end of the year, or within a 75-day period ending immediately after the termination of plaintiff's taxable year, which was December 31, 1950.

5. Plaintiff was organized in October 1916 as a corporation under the laws of the State of New York. From the time of its organization and to and including February 18, 1950, the capital stock of plaintiff, issued and outstanding, was owned in equal shares by David Radom and one Henry Neidorff, the husband of David Radom's sister, Anna. Henry Neidorff died on February 18, 1950, and his wife Anna, the sole executrix and legatee under the will of Henry Neidorff, succeeded to ownership and possession of a full one-half interest in plaintiff's stock then outstanding.

6. During the balance of the year 1950 and subsequently, David Radom and Anna Neidorff were engaged in a personal controversy relating to control of plaintiff. During the controversy, it was impossible to obtain the agreement of the stockholders for the election of directors and the appointment of officers. The controversy resulted in protracted litigation in the courts of the State of New York for the purpose of obtaining an enforced dissolution of plaintiff. The Court of Appeals of New York held, on April 22, 1954, in *In re Radom & Neidorff, Inc.*, 307 N.Y. 1, 119 N.E. 2d 563, that the dissolution sought by Radom by a dissolution proceeding instituted on July 17, 1950, should not, under the circumstances present, be granted; Anna Neidorff's refusal to sign Radom's salary checks being considered alone as an insufficient basis for a dissolution under the applicable provisions of New York's General Corporation Law.

7. During the entire year 1950, and during the 75-day period thereafter, and solely by reason of the said personal controversy, Anna Neidorff refused to countersign any check for any part of the compensation due to David Radom in payment for the services performed by David Radom for plaintiff. Anna Neidorff affixed her signature to all other checks issued by plaintiff. Plaintiff's bank required said countersignature in each instance or the check would not be paid.

8. Solely by reason of said action of Anna Neidorff, plaintiff was prevented from making any payment to David Radom during the year 1950 or within 75 days thereafter, and David Radom did not, during said period, receive any part of the amount due him as salary. David Radom was on the cash basis of accounting and did not report as income in 1950 or 1951 any part of the salary, for the year 1950, due him from plaintiff.

9. Plaintiff at all times admitted its liability for the full amount of David Radom's salary. Anna Neidorff did not contend that plaintiff was not liable for the full amount, but alleged that an offset was due to plaintiff. Plaintiff would have paid the full amount of $18,075 during the year 1950, or within 75 days thereafter at the latest, had Anna Neidorff countersigned a check in payment. Plaintiff accrued the entire obligation of $18,075 as an expense and deducted the full amount as officer's salary from gross income reported on its federal income and excess profits tax returns for the calendar year 1950.

10. Under date of July 29, 1954, David Radom mailed the following letter to the Director of Internal Revenue in New York:

> I, David Radom, do hereby consent to any additional tax assessment due to the application of Section 24c as amended by the Technical Changes Act of 1953 to my back salaries from Radom & Neidorff, Inc.

Under date of August 16, 1954, plaintiff mailed the following letter to said Director:

> Please be informed that we elect to come under the provisions of Technical Changes Act, of 1953 as applied to accrued salaries for the year 1950, under Section 24—C.

11. On January 21, 1955, the Commissioner of Internal Revenue, by registered mail, forwarded to plaintiff a statutory notice of a deficiency of $10,624.17 in plaintiff's income taxes for the calendar year 1950. The major cause for the claimed deficiency was the disallowance pursuant to section 24(c) of the Internal Revenue Code of 1939 of the entire amount of the deduction against gross income of $18,075,

claimed by reason of the accrual of salary due to plaintiff's president. As to this item, the Commissioner stated:

> (a) The deduction for compensation of officers claimed on your return for the taxable year ended December 31, 1950 has been disallowed to the extent of $18,075.00 in accordance with the provisions of Section 24(c) of the Internal Revenue Code of 1939, for the reason that that portion of the salary accrued to the president, Mr. David Radom, was not actually or constructively paid within two and one-half months after the close of the taxable year.

12. Plaintiff did not file a petition in the Tax Court of the United States and, in due course, the amount of the claimed deficiency was assessed. On or about June 21, 1955, plaintiff paid to the District Director of Internal Revenue the full amount of the assessment of $10,624.17, together with interest in the amount of $2,683.90.

13. On September 15, 1955, plaintiff filed with the Director of Internal Revenue the prescribed form constituting a claim for refund of the payment of income taxes so paid on the ground that the deficiency had been erroneously and illegally assessed and collected. As to the salary item, plaintiff stated:

> Claimant maintains that the deduction is fully allowable and that the said provisions of the Internal Revenue Code are not applicable since the nonpayment of the accrued salaries within the prescribed period was not occasioned by reason of the difference in the accounting methods of payor and payee, but rather by legal disability. Claimant maintains that a condition precedent to the applicability of the said section is that the nonpayment be directly the result of the difference in accounting methods.

14. On August 9, 1956, the District Director of Internal Revenue mailed to plaintiff, by registered mail, the prescribed statutory notice that the claim had been rejected in full.

15. Plaintiff is the sole owner of the claim herein presented and has not at any time assigned or transferred such claim nor any part thereof or interest therein. The claim presented herein has not been presented in any other court and no action thereon is pending in any other jurisdiction.

16. Pursuant to Rule 38(c), the parties, with the approval of the commissioner, agreed that there should be a separate determination of the right of plaintiff to recover, reserving the determination of the amount of recovery, if any, for further proceedings.

Conclusion of Law

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law that plaintiff is not entitled to recover, and the petition is therefore dismissed.